Overview of ESG in 2023

Materials Prepared for
Mergers and Acquisitions in India: is India the last oasis of hope in a global slowdown?

A conference presented by the IBA Corporate and M&A Law Committee

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Wachtell, Lipton, Rosen & Katz

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2022-23 Updates

Key Developments

What are the key ESG developments in the last twelve months?

Mandatory Disclosures

- SEC to release and/or adopt climate and other new ESG disclosure rules
- SEC has issued comment letters on climate and risk oversight disclosures
- EU / UK and others have adopted new climate and/or sustainability disclosure rules

Greenwashing

- SEC and EU continue to step up enforcement on misleading climate-related disclosures
- Growing scrutiny on sustainability-linked financing and targets
- Private class action lawsuits have been filed alleging deceptive marketing

Emerging: Geopolitics and Biodiversity

- War in Ukraine, tensions in the Taiwan Strait and uncertainty in the Middle East prompting investors to scrutinize geopolitical risks
- Climate change-related risks such as biodiversity coming to the fore

Key Developments *(cont'd)*

What are the key ESG developments in the last twelve months?

Macroeconomic Headwinds

- Investors and companies are prioritizing near-term balance sheet strength
- Energy transition plans in flux amid global energy shortages
- Investor support for more prescriptive ESG proposals decreased in 2022

Spotlight on Boards

- Increased investor and SEC focus on oversight and risk management
- Board education and expertise under scrutiny
- Board oversight responsibilities continue to expand

Anti-ESG Backlash

- Certain states have passed anti-ESG laws prohibiting pension funds from considering "non-pecuniary" factors; others have boycotted certain asset managers
- Pro and anti-ESG camps divided along political lines

"Big Three" Priorities

Asset Manager	Key Areas of Engagement with Public Companies
BlackRock	▪ Long-term strategic plan reviewed by board and updated (2016-19) ▪ Long-term approach ≠ infinite patience (2017-20) ▪ ESG (board composition, diversity, climate); human capital (2017-20) ▪ Corporate purpose; strategy, capital allocation and pay (2018-19) ▪ Purpose alignment with culture, strategy; world leadership (2019-20) ▪ Carbon emissions; stakeholder engagement; board and workforce diversity (2020-21) ▪ Board quality and effectiveness; strategy and purpose; compensation alignment; climate and nature; stakeholder impacts (2021-22) ▪ New emphasis on nature-related disclosures; advance sustainability reporting (2023)
State Street Global Advisors	▪ Structures for independent boards; long-term value (2016) ▪ Board to protect the long term in activist settlements (2016) ▪ Pay concerns; incentives aligned with strategy (2017-18) ▪ Sustainability in strategy/value creation (2017-20) ▪ Gender diversity on boards (2017-19) ▪ Board ownership of strategy and ESG (2018; 2020) ▪ Corporate culture alignment with strategy (2019-20) ▪ Climate change; racial and ethnic diversity (2020-21) ▪ Climate change; board and workforce diversity (2021-22)
Vanguard®	▪ Director involvement; strategy; informed voting (2016) ▪ Thinking like a long-term activist in the best sense (2017-18) ▪ Dealmaking with companies in activist situations (2017-19) ▪ Maintaining long-term focus; how does board work with and evaluate management (2017-20) ▪ "Four Pillars" (Board; Governance; Pay; Strategy/Risk) (2017-20) ▪ Societal risks as material risks to long-term value? (2019-20) ▪ Climate risk; board and workplace diversity (2020-21) ▪ Board composition and effectiveness (including diversity); oversight of strategy and risk (including climate and social risks); executive compensation; shareholder rights (2021-23)

ISS Proxy Voting Policy Updates

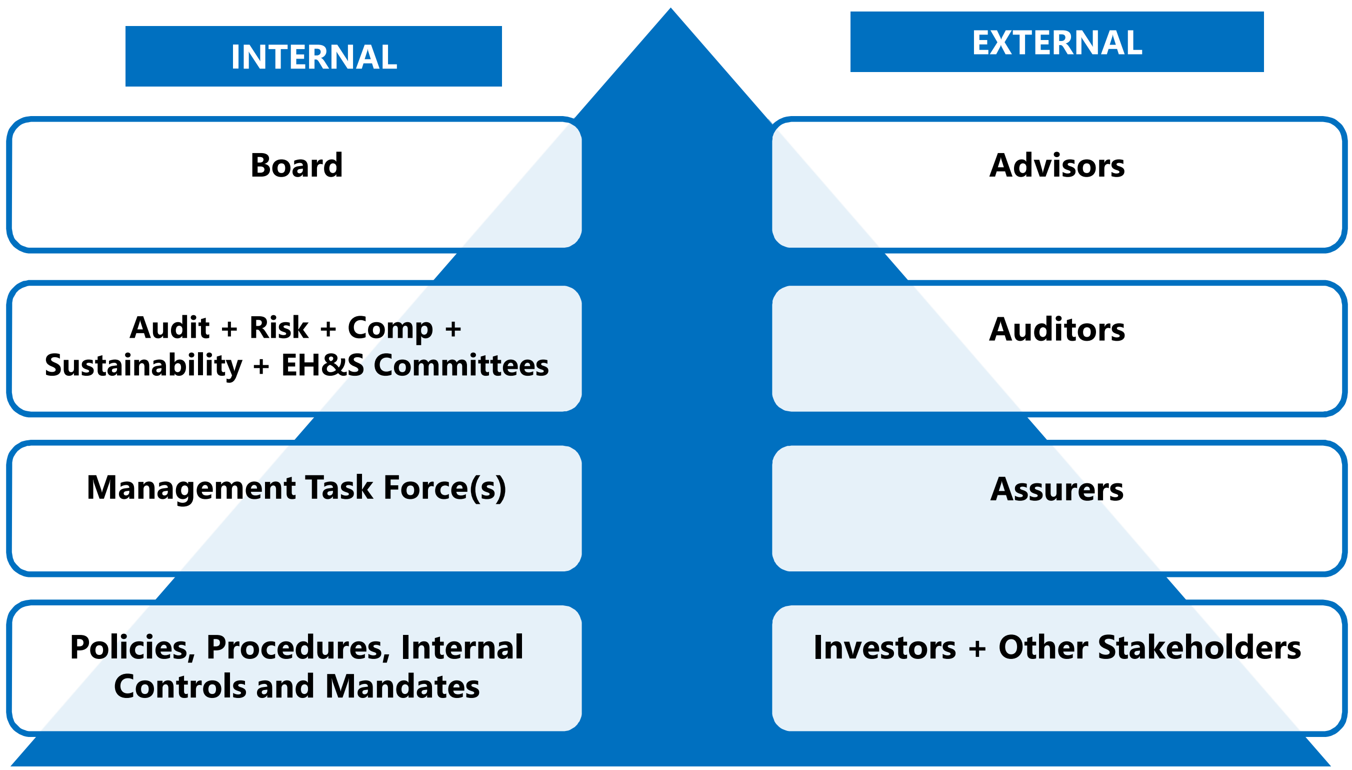
- ISS's 2023 voting policy targets **climate disclosures**, **board diversity** and **unequal voting rights**
  - Will vote "AGAINST" directors of companies that are "significant GHG emitters" (defined as those in the Climate 100+ Focus Group) and that do not provide adequate disclosures and Scope 1 & 2 GHG emissions targets covering 95% of operational emissions
  - Chairs of nominating committees without gender and racial and ethnic diversity will face "AGAINST" or "WITHHOLD" recommendations
  - Will recommend "FOR" shareholder proposals calling on companies to disclose financial, physical or regulatory risks they face related to climate change, greenhouse gas (GHG) emissions from company operations and/or products, and adopting GHG reduction goals
  - Will recommend "FOR" shareholder proposals calling for reports on energy-efficiency policies and feasibility of developing renewable energy resources, if relevant
  - "Say on Climate" proposals will be assessed on case-by-case basis, taking into account disclosure quality, rigor of targets, use of science-based targets and external verification
  - "Political congruency" proposals will be assessed on case-by-case basis, taking into account existing disclosures, policies, incongruencies identified between the company's direct and indirect political spending and publicly stated values and policies, and froversies

Glass Lewis Proxy Voting Policy Updates

- Glass Lewis's 2023 voting policy targets board diversity and unequal voting rights:
  - Will recommend "AGAINST" chair of nominating committee of a Russell 3000 company that is not at least 30% gender diverse
  - Will recommend "AGAINST" chair of nominating committee of a Russell 1000 company with no director from an "underrepresented community"
  - Will recommend "AGAINST" chair of nominating committee of a Russell 1000 company that has not provided any disclosure in its proxy statements in any of the following categories: (1) the board's current percentage of racial/ethnic diversity, (2) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity, (3) whether the board has adopted a "Rooney Rule" policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees and (4) board skills disclosure
  - Will recommend "AGAINST" chair of responsible board committee or governance committee of a company in the Climate Action 100+ Focus Group that fails to provide climate-related disclosures in line with TCFD recommendations
  - Will recommend "AGAINST" chair of governance committee of a Russell 1000 company that fails to provide explicit disclosure in its proxy statements or governance documents (e.g., committee charters) about the board's role in overseeing environment and social issues
  - When analyzing racial and equity proposals, Glass Lewis will assess (1) the nature of the company's operations, (2) the level of disclosure provided by the company and its peers on its internal and external stakeholder impacts and the steps it is taking to mitigate any attendant risks and (3) any relevant controversies, fines or lawsuits

Board and Management Responsibilities

Board Oversight of ESG



Boards are expected to **oversee significant** and "**mission critical**" ESG risks and **document** their oversight of the strategies, policies and procedures adopted to address such risks

The Board's Responsibilities

Boards are now expected to:

- **Stay abreast** of ESG and sustainability issues relating to the company and industry
- **Understand** the **ESG risks** and **opportunities** facing the company
- Oversee effective internal and external **ESG reporting** by management
- Oversee and ensure adequate **reporting and internal controls** on ESG risks and **integrate** ESG considerations into strategy and operations
- Recognize focus on "**purpose**," which encompasses stakeholder interests, and strike the **balance** between corporate purposes and ESG
- Oversee and, where needed, **participate** in **stakeholder engagement**
- Set the "**tone at the top**" to create a corporate culture that promotes ethical standards, professionalism, integrity and compliance

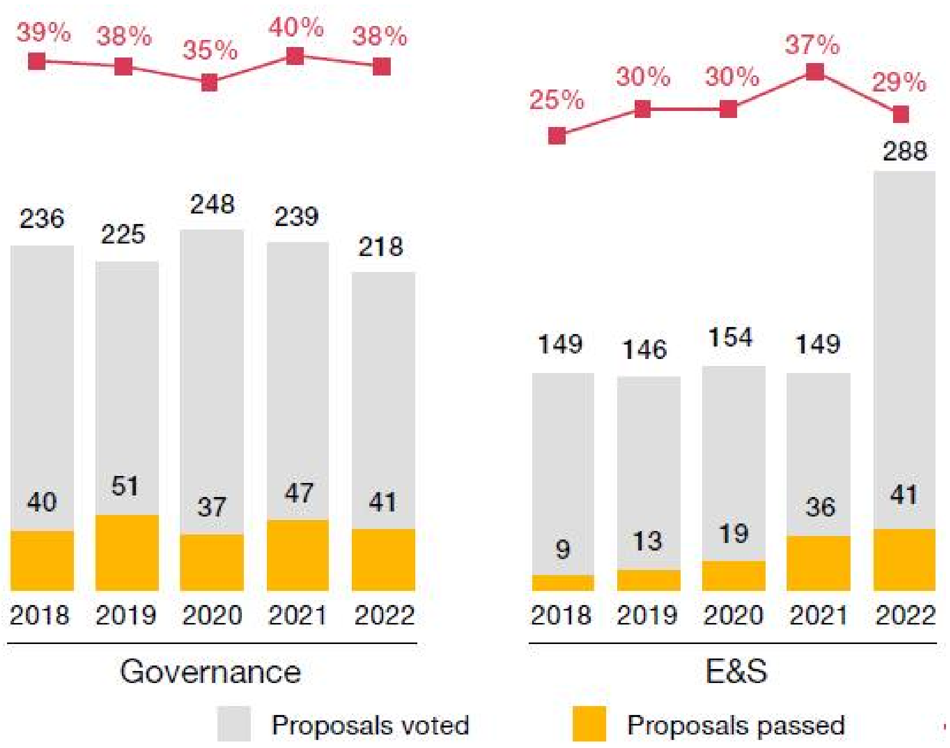
The legal duties of the board have not changed. But boards now face heightened expectations and scrutiny on ESG.

Considerations on ESG Board Oversight

- **No "one size fits all" approach to board oversight of ESG matters**
  - Oversight can occur at the full board level and/or at the committee level
  - The board may choose to delegate responsibilities among various committees
  - Companies expected to disclose allocation of responsibility and oversight
  - Consider existing governance framework and the relevant skills and competencies of director when allocating responsibilities
- **Board oversight can be shared among committees; flexibility is key**
  - Oversight can occur at the full board, nominating and governance committee, compensation committee, audit committee or a specialized committee
  - Growing SEC focus on ESG disclosures may demand **greater participation from the audit committee**
    - SEC has issued guidance on the inclusion of key performance metrics (including ESG metrics) in MD&A disclosures; Regulation S-K was amended to require disclosure of human capital resources
    - SEC's forthcoming climate rules will likely require significant qualitative disclosures and assurance
  - Oversight structure should be flexible to accommodate ongoing shifts in investor expectations and market practices

Shareholder Proposals

Support for ESG Proposals Decreased in 2022 While Total Number of Proposals Increased



Source: Proxy Analytics

What to Expect in 2023

- ESG proposals are likely to continue to grow
- Focus areas include climate and sustainability, lobbying, workforce DEI and racial equity audits
- Anti-ESG proposals are on the rise
- Investors will likely remain cautious around highly prescriptive E&S proposals
- Executive compensation and its ties to ESG performance will be under scrutiny by asset managers

ESG and Activism

- **Activists have leveraged ESG as a wedge issue to rally support of institutional investors around economic and governance theses; some are also raising ESG concerns as a stand-alone thesis**
- Growing recognition of ESG factors as independent drivers of long-term value has led to increased investor support for ESG-oriented activism

Engine No. 1	**Engine No. 1 teamed up with CalSTRS in campaign against ExxonMobil**	Inclusive Capital Partners	**Criticized Bayer for undervaluing the sustainable qualities of its crop sciences division**
Inclusive Capital	**Inclusive Capital Partners is an ESG-focused activist fund led by Jeff Ubben (formerly of ValueAct)**	Impactive Capital	**Focused on driving long-term returns using ESG lens**
Elliott	**Criticized the lack of gender diversity on the board of Commvault**	Standard General	**Criticized TEGNA for lack of board diversity**
TCI Fund Management	**TCI launched “say on climate” campaign**	Bluebell Capital Partners	**Campaigned to oust CEO of Solvay following seawater pollution**
Third Point	**Called for the separation of Royal Dutch Shell; cited carbon footprint reductions in pushing Prudential plc to “break up” in 2020**	Legion Partners	**Touted its track record of nominating diverse directors in its campaign against Genesco; criticized Guess for failing to address sexual harassment allegations**

SEC ESG Enforcement Actions

Goldman Sachs	On November 22, 2022, the Securities and Exchange Commission charged Goldman Sachs Asset Management, L.P. (GSAM) for policies and procedures failures involving two mutual funds and one separately managed account strategy marketed as Environmental, Social, and Governance (ESG) investments. To settle the charges, GSAM agreed to pay a $4 million penalty.
COMPASS MINERALS	On September 23, 2022, the Securities and Exchange Commission announced settled charges against Compass Minerals International Inc. for misleading investors about a technology upgrade that the company claimed would reduce costs at its most significant mine, but in reality, had increased costs, and for failing to properly assess whether to disclose the financial risks created by the company's excessive discharge of mercury in Brazil. Compass was ordered to pay $12 million to settle the charges.
VALE	On April 28, 2022, the Securities and Exchange Commission charged Vale S.A., a publicly traded Brazilian mining company and one of the world's largest iron ore producers, with making false and misleading claims about the safety of its dams prior to the January 2019 collapse of its Brumadinho dam. The collapse killed 270 people, caused immeasurable environmental and social harm, and led to a loss of more than $4 billion in Vale's market capitalization.
NIKOLA™	On July 29, 2021, the Securities and Exchange Commission announced charges against Trevor R. Milton, the founder, former CEO and former executive chairman of Nikola Corporation, for repeatedly disseminating false and misleading information – typically by speaking directly to investors through social media – about Nikola's products and technological accomplishments.
FCA FIAT CHRYSLER AUTOMOBILES	On September 28, 2020, the Securities and Exchange Commission filed an order against Fiat Chrysler Automobiles N.V. (FCA) involving violations by FCA concerning its public descriptions in 2016 of an internal inquiry of the emissions control systems of certain of its light-duty diesel vehicles in the wake of the Volkswagen AG "Dieselgate" scandal. By making misleading statements regarding emissions, FCA allegedly violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder.

Regulatory Landscape

SEC Rulemaking

2021 — 2022 — 2023

Nov. 2021: Shareholder Proposals – SLB 14L

Mar. 2022: Climate-Related Disclosures for Public Companies (Proposed)

Mar. 2022: Cybersecurity Disclosures (Proposed)

May 2022: Climate-Related Disclosures for Funds (Proposed)

May 2022: Russia / Ukraine Comment Letter

May 2022: Investment Company Names (Proposed)

July 2022: Rule 14a-8 Amendments (Proposed)

Late 2022-present Climate and Risk Oversight Comment Letters

Apr. 2023: Cybersecurity Risk Governance Disclosures (Expected Final)

Apr. 2023: Climate Disclosures (Expected Final)

The last twelve months have seen a flurry of ESG-related rulemaking from the SEC, a pattern that will continue into 2023 . . .

SEC Rulemaking *(cont'd)*

April

- Proposed Human Capital Disclosures
- Proposed *additional* Cybersecurity Disclosures (registrant cybersecurity risk and related disclosures, amendments to Regulation S-P and Regulation SCI, and other enhancements related to the cybersecurity and resiliency of certain Commission registrants)

October

- Proposed Board Diversity Disclosures
- Final Rule 14a-8 Amendments
- Final "Names Rule" Amendments

Ongoing

- SEC has issued comment letters requesting additional 10-K and proxy statement disclosures on **climate-related risks** and **management and board risk oversight practices**
- SEC continues to step up enforcement action against companies and asset managers that have made misstatements in their public disclosures

Proposed SEC Climate-Related Disclosures

- **Financial Statement Disclosures**
  - Costs and expenditures relating to climate change events, transition activities and related estimates and assumptions
  - Required for climate-related costs that exceed 1% of the total affected line item
- **Mandatory Scopes 1 & 2 Disclosure and Assurance with Limited Phase-In**
  - One-year phase-in for Large Accelerated Filers (2023)
  - Transition from "Limited Assurance" to "Reasonable Assurance" beginning 2026
- **Scope 3 Disclosure with Limited Phase-In**
  - Required ***if*** material or ***if*** the company has already set targets
  - Two-year phase-in for Large Accelerated Filers (2024)
- **Scenario Analysis, Internal Carbon Price, Transition Planning, Targets and Goals**
  - Required ***if*** already in use (note: definitions of each are extremely broad)
- **Board and Management Oversight**
  - Including board expertise on climate-related risks
- **Limited Safe Harbors**
  - Forward-looking statement safe harbor not extended to IPO registration statements
- **Granular Disclosure of Climate-Related Risks Near-, Medium- and Long-Time Horizon**

While this rule is likely to be challenged in the courts, the SEC will likely seek adoption by April 2023

Proposed SEC Cybersecurity Disclosures

- **8-K Disclosure of Material Cyber Incidents**
  - Nature, scope and operational impact of the incident, whether data was stolen or compromised, and whether remediation efforts are ongoing or complete
  - Disclosure within <u>four business days</u> after the company deems the cybersecurity incident to be material
  - No disclosure relief for pending investigations or where applicable state laws or other regulatory regimes may permit a delayed disclosure due to law enforcement or other investigatory imperatives
- **Continuous 10-Q and 10-K Reporting**
  - Updated disclosure on previously reported cyber incidents
  - Disclosure of previously immaterial incidents that become material
- **Cybersecurity Governance and Strategy Disclosures**
  - Policies, procedures and strategies, including:
    - Identification and management of operational risk, IP theft, fraud, extortion, harm to employees or customers, violation of privacy laws, litigation and reputational risk
    - Post-incident contingency, continuity and recovery plans and strategies for managing cybersecurity risks associated with third-party service providers
    - Impact on business strategy, financial planning and capital allocation decisions
  - Board oversight role and expertise, including frequency of discussions
  - Management role and expertise, including reporting processes and frequency

The SEC will likely seek adoption by April 2023

Other Notable U.S. Regulatory Developments

Rules and Regulations	Scope / Impact	Adoption Timeline
Uyghur Forced Labor Protection Act	➢ Prohibits the import of all goods "mined, produced, or manufactured, wholly or in part, by forced labor from the People's Republic of China, and particularly . . . the Xinjiang Uyghur Autonomous Region of China" ➢ All goods manufactured in Xinjiang shall be banned from the United States unless "clear and convincing evidence" is provided to prove that such goods were not made by forced labor ➢ Shifts burden on companies to audit their supply chains and policies and procedures aimed at mitigating labor law violations	Adopted December 23, 2021, and fully effective June 21, 2022
Proposed Climate Accountability Package (SB 253 and SB 261)	➢ SB 253 would require entities conducting business in California with total annual revenues over $1 billion to disclose annually and verify Scopes 1, 2 and 3 emissions beginning 2026 ➢ SB 261 would require entities conducting business in California with total annual revenues over $500 million to disclose climate-related financial risk in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD")	Under review in the California Senate
Proposed Federal Acquisition Regulation Amendment	➢ Would require certain federal contractors disclose their greenhouse gas emissions and climate-related financial risk and set science-based targets to reduce their greenhouse gas emissions.	Pending review

EU / UK / Global Regulatory Changes

Rules and Regulations	Scope / Impact	Adoption Timeline
EU Corporate Sustainability Reporting Directive (CSRD)	➢ Applicable to non-EU companies with (1) net turnover > €150 million in the EU and (2) at least one qualifying subsidiary in the EU ➢ Expands upon existing disclosures to require disclosures in accordance with forthcoming EU sustainability reporting standards and the audit of reported information ➢ Will require "**double materiality**" disclosures	Beginning 2025 (for 2024 fiscal year) for currently non-reporting EU subsidiaries and beginning 2029 (for 2028 fiscal year) for non-EU companies
European Sustainability Reporting Standards (ESRS)	➢ Sets out required disclosures under CSRD; initial draft included disclosures relating to climate change; pollution; water and marine resources; biodiversity; resource use and circular economy; workforce; workers in the value chain; affected communities; consumers and end-users; governance, risk management, and internal control; and business conduct.	Anticipated June 30, 2023
EU Carbon Border Adjustment Mechanism	➢ Imposes carbon tax on imported products with value > €150 million ➢ EU importers will need to declare emissions embedded in imported goods ➢ Initial scope covers cement, aluminum, fertilizers, electric energy production, iron and steel products; covered goods may expand to include downstream industries such as tools, machines, vehicles, plastics	Anticipated to be phased in beginning October 2023

EU / UK / Global Regulatory Changes *(cont'd)*

Rules and Regulations	Scope / Impact	Adoption Timeline
European New Deal	➢ Series of policy initiatives with the goal of making the European Union climate neutral by 2050, including: ▪ Circular economy action plan ▪ "Farm to fork" strategy on sustainable food systems ▪ Biodiversity strategy ▪ Carbon capture and storage ▪ Forest protection strategy ▪ Social climate fund	Ongoing
UK FCA Sustainability Disclosure Rules	➢ Mandatory disclosures for listed UK issuers aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) ➢ Disclosures at entity and product-level for UK-based asset managers currently proposed	Disclosures for UK and GDR issuers came into force beginning Jan. 1, 2021; new investment rules expected to be finalized middle of 2023 with reporting commencing 2024/25

EU / UK / Global Regulatory Changes *(cont'd)*

Rules and Regulations	Scope / Impact	Adoption Timeline
Australia	➢ Consultation paper released proposing adoption of the TCFD framework but with flexibility to accommodate the standards being developed by the International Sustainability Standards Board (ISSB), once finalized, including mandatory Scope 3 emissions reporting	Ongoing
New Zealand	➢ Mandatory disclosures aligned with the TCFD framework for issuers listed in New Zealand, large registered banks, licensed insurers and managers of investment schemes	Commencing 2023
Japan	➢ Japan Financial Services Agency has proposed a hard law amendment that will require sustainability disclosures for publicly listed companies covering governance, risk management, strategy and targets	Commencing March 31, 2023

Voluntary Reporting Frameworks & Standards

International Sustainability Standards Board

- Climate and sustainability frameworks based on SASB and TCFD to be finalized in mid-2023
- Expected to be adopted by the UK; Australia and China are considering adoption
- **Represents significant convergence of frameworks**

Task Force on Climate-related Financial Disclosures

- Framework to help companies provide decision-useful information on risks and opportunities from climate change
- Disclosure focused on governance, strategy, risk and metrics/targets

United Nations Sustainable Development Goals (SDGs)

- Stakeholder-focused framework comprised of 17 goals to advance the UN Agenda for Sustainable Development

Voluntary Reporting Frameworks & Standards

CDP Questionnaires

- Annual questionnaires on climate, forest and water, which are graded by CDP and released on its website
- Questionnaires cover governance, risks, strategy, targets and performance and subject matter specific topics such as emissions, carbon pricing, engagement and biodiversity

Global Reporting Initiative (GRI)

- Wide-ranging standards based on economic, environmental and social topics
- Stakeholder-centric approach, applying "**double materiality**"
- Basis for forthcoming mandatory EU climate and sustainability disclosures

Task Force on Nature-related Financial Disclosures

- Disclosure framework to report and act on evolving nature-related risks
- Draws upon the TCFD framework, with focus on governance, strategy, risk and metrics/targets
- Draft expected to be finalized in Q3 2023

ISSB and the Future of Voluntary Reporting

- The forthcoming ISSB climate and sustainability disclosure standards build on SASB and TCFD standards, but issuers should take note that ISSB will not entirely supersede SASB and TCFD (at least for now)
- ISSB has confirmed that **industry-specific** disclosures are required and, in the absence of specific ISSB standards, companies **must consider** the SASB standards
- ISSB will continue to update and improve existing SASB standards to complement the new ISSB sustainability disclosure standards
- **In 2023, companies that already use the SASB and TCFD should continue to do so, while preparing to onboard the new ISSB standards**
- **In addition, CDP has updated its questionnaires to align with TCFD recommendations and its grading is increasingly used as an indicator of a company's compliance with TCFD's recommendations**

The Anti-ESG Movement

Overview

- Over the past 18 months, there has been a growing wave of anti-ESG backlash targeted primarily at the largest asset managers and financial institutions, but also directed at certain large companies
- Broadly, the backlash has taken three forms:
  1. State-level legislation that seeks to prohibit the consideration of non-pecuniary factors in pension investments and to boycott financial institutions that utilize ESG investment strategies
  2. Anti-ESG shareholder proposals focused on unwinding ESG initiatives adopted by companies
  3. The emergence of contrarian / anti-ESG investment vehicles, such as Strive Asset Management, which seeks to use its proxy voting power for the sole purpose of maximizing shareholder returns without giving consideration to ESG factors

STRIVE ASSET MANAGEMENT

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